No. 12782.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CONTROLLER OF THE STATE OF CALIFORNIA,

Appellant,

vs.

ARLIE R. LOCKWOOD, Bankrupt,

Appellee.

APPELLANT'S OPENING BRIEF.

EDMUND G. BROWN,
Attorney General;
JAMES E. SABINE,
Deputy Attorney General;
EDWARD SUMNER,
Deputy Attorney General,
600 State Building,
Los Angeles 12, California,
Attorneys for Appellant.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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I.

Preliminary Jurisdictional Statement.

Arlie R. Lockwood filed his Petition under Chapter XI of the Bankruptcy Act with the District Court of the United States for the Southern District of California, Central Division, on the 30th day of August, 1946 [Tr. 3-10], the United States District Court as a court of bankruptcy having jurisdiction pursuant to the Act of July 1, 1898, as amended. (Ch. 541, Secs. 1, 2, 30 Stat. 544, 545 as amended; United States Code, Title XI, Ch. 1, Sec. 1, Ch. 2, Sec. 11.) Lockwood's Petition was approved by the Honorable Ben Harrison, Judge of said Court, and the matter referred to Hugh L. Dickson, Esq., one of the Referees in Bankruptcy of said Court. [Tr. 10-11.] Thereafter, on October 4, 1946, and within the time provided by law, appellant, Controller of the State of California, duly filed his proof of claim for taxes due from

Lockwood under the California Motor Vehicle Fuel License Tax Law, California Revenue and Taxation Code, Sections 7301-8403, the amount of tax liability disclosed by said proof of claim amounting to the sum of $29,280.85, plus additionally accruing interest in the sum of $67.35 for each and every month or fraction thereof commencing November 1, 1946. [Tr. 11-12, 20-22.]

On October 11, 1946, Arlie R. Lockwood, as Debtor in the aforesaid pending Chapter XI proceedings, and E. A. Lynch, the duly appointed Receiver therein, filed objections to the aforesaid claim of appellant, the objections being predicated upon the allegations that Mr. Lockwood was not indebted to appellant for any of the tax items set forth in the aforesaid proof of claim, that Mr. Lockwood had not sold or distributed the gallonage of gasoline upon which the aforesaid proof of claim was predicated and that the tax assessment upon which the proof of claim was predicated had been made solely upon suspicion and without any legal or factual basis. [Tr. 12, 24-25.] The aforesaid objections of Mr. Lockwood and E. A. Lynch, as Receiver for Mr. Lockwood's estate, were duly set for hearing on October 17, 1946, before the Honorable Hugh L. Dickson, the Referee in Bankruptcy to whom the pending proceedings had been referred, and on that date with the consent of the Court appellant filed an amended proof of claim for taxes due under the California Motor Vehicle Fuel License Tax Law in the sum of $31,017.47 plus additionally accruing interest in the sum of $71.42 for each and every month or fraction thereof commencing November 1, 1946. [Tr. 12, 26-32.] On October 22, 1946, Mr. Lockwood and E. A. Lynch, as Receiver of Mr. Lockwood's estate, filed their objections to the aforesaid amended claim on the same grounds as set forth in their

former objections, additionally objecting to the inclusion of penalties and interest and alleging also that appellant's claim did not sufficiently itemize the transactions upon which the tax assessments were predicated. [Tr. 12-13, 33-35.]

The objections filed by Mr. Lockwood and E. A. Lynch, as Receiver for Mr. Lockwood's estate, to appellant's aforesaid amended proof of claim regularly came on for hearing before the Honorable Hugh L. Dickson, the Referee in Bankruptcy having jurisdiction of the matter, on the 22nd and 28th days of October and on the 1st and 27th days of November, 1946. After oral and documentary evidence had been introduced on behalf of all interested parties and the matter fully argued before the Referee, the Honorable Referee found that the objections raised by Mr. Lockwood and Mr. Lynch to appellant's amended claim had not been sustained and on January 16, 1947, the Referee formally entered his order that said objections be overruled and that the claim be allowed in full as a prior lien claim for taxes in the sum of $31,212.08, together with additionally accruing interest in the sum of $71.54 for each and every month or fraction thereof after December 31, 1946, to date of payment. [Tr. 13-14, 35-36.]

Four days after the Honorable Referee made his Order overruling the objections filed by Messrs. Lockwood and Lynch, Mr. Lynch filed a Petition for instructions as to whether he should file a Petition for Review of said Order [Tr. 14, 37-38] and on January 21, 1947, the Referee, finding that it would not be to the best interests of Mr. Lockwood's estate that such a review be taken, ordered and instructed Mr. Lynch, as Receiver, not to file a Peti-

tion for Review. [Tr. 14, 39.] *No appeal was taken from the Referee's Order instructing Mr. Lynch, as Receiver, not to petition for review.*

The Receiver having been instructed not to petition for review of the Referee's Order, Mr. Lockwood himself, as debtor in the pending Chapter XI proceedings, proceeded on his own to file a Petition for Review of the Referee's Order allowing appellant's claim. [Tr. 14-15, 40-44.] Although Mr. Lockwood's Petition for Review requested that a reporter's transcript of the hearings had before the Referee be attached to the Referee's certificate, neither Mr. Lockwood nor his attorneys took any action to initiate the preparation of that transcript, although repeatedly requested to do so by attorneys for appellant. Furthermore, although Mr. Lockwood was ordered, upon a Petition filed by appellant, to appear before the Referee on the 17th day of July, 1947 (seven months after the entry of the Referee's Order overruling Mr. Lockwood's objections to appellant's claim) and show cause why the Referee should not prepare his certificate on review without adding a reporter's transcript thereto but adding only the items thereafter in fact attached, as disclosed by the record herein, neither Mr. Lockwood nor his attorneys appeared at the time set, and the Referee accordingly made his Order for the preparation of his certificate on review as prayed for by appellant. [Tr. 15-19, 49-52.]

On November 4, 1947, the Referee filed his certificate on review [Tr. 11-19] and on January 5, 1948, after Mr. Lockwood's Petition for Review had been submitted upon the filing of briefs, District Judge Harrison remanded the matter to the Referee with directions to prepare adequate Findings of Fact and Conclusions of Law to preclude a reversal by the Circuit Court on technical

grounds. Thereafter, the Referee made and entered a *nunc pro tunc* order amending his previous order allowing appellant's claim to conform to the figures disclosed thereon to correct an inadvertent clerical error [Tr. 54-55], and on September 23, 1948, the Referee made, signed and filed his Findings of Fact and Conclusions of Law. The *nunc pro tunc* order, as well as the Findings of Fact and Conclusions of Law, were thereafter transmitted to the District Judge before whom Mr. Lockwood's Petition for Review was pending as attachments to the Referee's supplementary certificate on review dated January 28, 1949. [Tr. 53-54.]

On February 10, 1949, Mr. Lockwood having been adjudicated a bankrupt and E. A. Lynch thereupon having been appointed as Trustee in Bankruptcy to succeed himself as Receiver under Chapter XI, the attorneys for the Trustee filed a motion in the District Court for an order permitting the Trustee to furnish and add to the record on Mr. Lockwood's Petition for Review a reporter's transcript of the proceedings had before the Referee. [Tr. 63-72.] As is disclosed in the affidavit filed by attorneys for the trustee in support of the aforesaid motion [Tr. 71], representations were made to the Court that the expense of preparing the reporter's transcript would be borne by some of Mr. Lockwood's creditors. On the 28th day of February, 1949, District Judge Campbell E. Beaumont made his minute order granting the motion filed by attorneys for the trustee that a transcript be prepared and added to the record on Mr. Lockwood's Petition for Review and ordered that the transcript be pre-

pared at the expense of Ben Hur Refining Company, one of Mr. Lockwood's creditors, despite the fact that the only petition pending before the Court was a petition filed by Mr. Lockwood himself.

Thereafter, the Honorable Harry C. Westover, District Judge to whom Mr. Lockwood's Petition for Review originally pending before the Honorable Campbell E. Beaumont had been reassigned, reversed the Referee's Order allowing appellant's claim in full and instructed the Referee to disallow the entire claim on the ground that the Referee's findings were not supported by the evidence. [Tr. 73-85.] Judge Westover's formal Findings, Conclusions of Law and Judgment were signed by him on November 3, 1950, and judgment entered that same day. [Tr. 80-85.]

Within the time allowed by law, and in accord with the Rules of this Court, appellant filed his Notice of Appeal from the Order of the Honorable Harry C. Westover reversing the Order of the Referee below [Tr. 86]; Undertaking for Costs on Appeal [Tr. 86-89]; Appellant's Designation of Record on Appeal [Tr. 89-91]; Statement of Points Upon Which Appellant Intends to Rely [Tr. 323-325]; and Appellant's Designation of Record to be Printed. [Tr. 326.]

The jurisdiction of the Court of Appeals is invoked pursuant to Sections 24 and 25 of the Bankruptcy Act. (Act of July 1, 1898, as amended; Chapter 541, Secs. 24, 25; 30 Stat. 533, as amended; United States Code, Title XI, Ch. 4, Secs. 47 and 48.) Appellate jurisdiction in this matter vested in the Court of Appeals upon the filing on November 29, 1950, of the Notice of Appeal, the amount involved being in excess of $500.

II.

Statement of the Case.

Inasmuch as the District Judge predicated his Order reversing the Referee's allowance of appellant's claim upon the sole ground that the Referee's findings were not supported by the record, we present herwith an analysis of appllant's claim and an analysis of the testimony and evidence offered by Mr. Lockwood and the then Receiver in support of their objections to said claim as well as the additional testimony and evidence offered on behalf of appellant in support of his claim.

A. Appellant's Claim.

The claim under consideration is the "Amended Proof of Priority Claim for Taxes" which was filed with the Court's consent on October 17, 1946. [Tr. 12, 26-32.] The proof of claim discloses on its face that Mr. Lockwood was indebted to the Controller of the State of California for taxes, penalties and interest accrued under the provisions of the California Motor Vehicle Fuel License Tax Law, California Revenue and Taxation Code, Sections 7301-8403, as the result of illegal distributions of motor vehicle fuel disclosed by an audit of Mr. Lockwood's books and records for the months of January, May, June, July and September, 1945, and April and May, 1946. The exhibits attached to appellant's proof of claim are copies of the assessments or "determinations" of the liability disclosed by audit of Mr. Lockwood's books and records, the assessments being predicated upon illegal distributions of 5,149 gallons of motor vehicle fuel in January of 1945; 73,156 gallons in May of 1945; 216,539 gallons in June of 1945; 139,597 gallons in July of 1945; 17,787 gallons in September of 1945; 20,988 gallons in April of 1946; and

2,920 gallons in May of 1946. [Tr. 28-32.] Inasmuch as the rate of tax per gallon, penalty and interest is specified by the taxing statute, all amounts of tax, penalty and interest disclosed on appellant's proof of claim and attached exhibits can be simply verified by reference to Sections 7351, 7726-7728, inclusive, and 7706.

B. Analysis of Testimony and Evidence Offered Before the Referee in the Course of Hearings Had on Objections to Appellant's Claim.

Although the hearings before the Referee were initiated by the filing of objections by Mr. Lockwood and Mr. Lynch, the Receiver in the then pending Chapter XI proceeding, the reporter's transcript discloses that appellant, rather than the objecting parties, was compelled by the Referee to go forward and establish the validity of appellant's claim despite the well-established principle that verified proofs of claim are *prima facie* valid. [Tr. 95-97.] It is also to be noted that although appellant's counsel sought at the outset of the hearings before the Referee to offer in evidence certified copies of the assessments (determinations) attached to appellant's proof of claim as Exhibits "B," "C," "D," and "E" in accordance with the provisions of the California Motor Vehicle Fuel License Tax Law, pursuant to Section 7730 of that Law, to make the *prima facie* showing specified by that Law, he was not permitted to do so, it being the Referee's ruling that the items were not admissible until Mr. Lockwood's tax liability had otherwise been established. [Tr. 93-101.]

It being the Referee's position, as aforesaid, that appellant had the burden of going forward as well as the burden of proving that his claim was allowable, despite the fact that the noticed hearing before the Referee was

a hearing upon objections filed by Mr. Lockwood and the Receiver in the then pending Chapter XI proceedings [Tr. 33-35], the first witnesses called on behalf of appellant were Harold S. Williams, Supervising Investigator for the California State Board of Equalization (the duly constituted State agency charged with the administration —although not the collection—of the tax imposed by the California Motor Vehicle Fuel License Tax Law) and Joseph C. Akers, an attorney also employed by the California State Board of Equalization. Appellant's counsel sought through these two witnesses to lay the foundation for the introduction of the aforesaid certified copies of the assessments. Appellant's counsel was unsuccessful in this connection but counsel for the objecting parties did stipulate [Tr. 107] that Mr. Lockwood had paid no taxes under the California Motor Vehicle Fuel License Tax Law as a distributor. The Referee reiterated his ruling that the objecting parties did not have to proceed in support of their objections but that the burden of going forward and establishing the validity of appellant's claim was on appellant. Mr. Lynch was next called on behalf of appellant and his testimony in the main consisted of affirming the fact that none of the aforementioned assessments had been paid.

Mr. Lockwood was next called as a witness on behalf of appellant and he reaffirmed the fact that the aforesaid assessments had not been paid. [Tr. 113.]

Commencing at page 115 of the Transcript, Mr. Lockwood testified that he had sold gasoline in which was mixed 792 gallons of kerosene and that he had not reported and paid to the State of California any motor vehicle fuel license tax in connection with the aforesaid sale of 792 gallons of kerosene. It is clear from the transcript, at

page 119, that the assessment, a copy of which was attached to appellant's amended proof of claim as Exhibit "D," related to this kerosene gallonage; that said notice of assessment or notice of determination had been duly mailed to and received by Mr. Lockwood. Appellant's attempt at this point to establish that Mr. Lockwood had been engaged in the making of black market sales of gasoline during the taxable periods involved while gasoline rationing was in effect was frustrated by the sustaining of objections to questions propounded by counsel for appellant in that connection. [Tr. 114, 121-122.]

It having become apparent to counsel representing appellant at the hearing before the Referee that he had no choice but to accept the burden of going forward and establishing the validity of appellant's claim, he thereupon called on behalf of appellant Virgil M. Lyles, Supervising Auditor employed by the Board of Equalization, who had reviewed and audited the brokerage returns filed by Mr. Lockwood for the period January 1, 1945, to August 31, 1946, inclusive, and who had audited Mr. Lockwood's books and records for the calendar year 1945. [Tr. 129.] Mr. Lyles' testimony makes it clear that the assessments upon which appellant's claim is predicated were based upon sales of motor vehicle fuel disclosed by Mr. Lockwood's books and records which exceeded the gallonage purchased by him tax-paid from licensed distributors. Mr. Lyles' testimony regarding the manner in which he ascertained the gallonage sold by Mr. Lockwood during the months of January, May, June, July and September of 1945, and the manner in which he checked to ascertain whether the gallonage so sold had been purchased by Mr. Lockwood tax-paid from a licensed distributor clearly

supports the tax assessments attached to appellant's proof of claim.

Commencing at page 131 of the transcript, Mr. Lyles testified that in auditing Mr. Lockwood's books and records he found an opening inventory for the month of January, 1945 of 1,467 gallons. The purchases made by Mr. Lockwood during January of 1945 tax-paid from licensed distributors, as revealed by Mr. Lockwood's books and records, amounted to 116,314 gallons. This latter gallonage is within two gallons of the purchases reported by Mr. Lockwood on his broker's report. (It should be noted at this point that "broker" under the California Motor Vehicle Fuel License Tax Law does not include a distributor, it being the distributor who is subject to tax under this Law.) Adding the opening inventory for January of 1,467 gallons to the tax-paid purchases from licensed distributors during that period, it is clear that Mr. Lockwood had available for sale during the month of January 117,781 gallons of tax-paid gasoline. The sales disclosed by Mr. Lockwood's books and records, however, amounted to 122,130 gallons, or 4,349 gallons more than Mr. Lockwood's records disclosed had been acquired tax-paid from licensed distributors. This excess gallonage is the first item included in the notice of determination attached to appellant's proof of claim as Exhibit "B."

Having ascertained from Mr. Lockwood's books and records that he had sold more gasoline during January than he had acquired tax-paid from licensed distributors, Mr. Lyles then testified, commencing at page 133 of the transcript, that he continued his audit and calculations on the assumption that Mr. Lockwood had no opening inventory of tax-paid gasoline for the month of February.

Mr. Lockwood's records for February, March and April appeared to check out, leaving an opening inventory for the month of May, 1945, of 8,383 gallons. Audit of Mr. Lockwood's books and records for the month of May, 1945, disclosed that Mr. Lockwood purchased 157,055 gallons of tax-paid gasoline from licensed distributors, this latter gallonage being exactly the amount disclosed in a broker's report filed by Mr. Lockwood for that month. [Tr. 135.] Adding the opening inventory of 8,383 gallons to purchases of 157,055 gallons, it is clear that Mr. Lockwood had available for sale during the month of May, 1945, 165,438 gallons of tax-paid gasoline purchased from licensed distributors. The sales disclosed by Mr. Lockwood's records, however, amounted to 236,934 gallons, or 71,496 gallons in excess of the amount of tax-paid gasoline available for sale. This excess gallonage amounting to 71,496 gallons appears as the second item on the notice of determination attached to appellant's proof of claim as Exhibit "B."

Inasmuch as Mr. Lyles' audit of Mr. Lockwood's books and records for the month of May, 1945, disclosed sales in excess of purchases of tax-paid gasoline from licensed distributors, Mr. Lyles continued his audit and calculations on the necessary assumption that Mr. Lockwood had no opening inventory of tax-paid gasoline for the month of June. [Tr. 138, *et seq.*] The purchases of tax-paid gasoline made by Mr. Lockwood from licensed distributors during the month of June, as disclosed by his records, totaled 122,278 gallons and constituted the total gallonage of tax-paid gasoline available for sale. The sales disclosed by Mr. Lockwood's records, however, amounted to 338,817 gallons, or 216,539 gallons in excess of the amount purchased from licensed distributors and available

for sale as tax-paid gasoline. The 216,539 excess gallons sold by Mr. Lockwood during June of 1945, as disclosed by his books and records, constitute the third item on the notice of determination attached to appellant's proof of claim as Exhibit "B." [Tr. 139.]

Mr. Lockwood's sales during the month of June having exceeded the total amount of tax-paid gasoline purchased from licensed distributors, Mr. Lyles continued his audit and calculations for the month of July [Tr. 139], again upon the necessary assumption that Mr. Lockwood's opening inventory for the month of July of tax-paid gasoline amounted to zero. The purchases of tax-paid gasoline disclosed by Mr. Lockwood's books and records for the month of July amounted to 276,939 gallons and constituted the total amount of tax-paid gasoline available for sale. The sales, however, again exceeded the amount of tax-paid gasoline available for sale and amounted to 366,390 gallons, and a physical inventory taken by the investigating department of the California State Board of Equalization on the 31st day of July disclosed that Mr. Lockwood had on hand that day an additional 49,354 gallons. Adding the total amount of sales for the month of July, or 366,390 gallons, to the gallonage on hand as of July 31st as disclosed by the taking of a physical inventory on that date, we arrive at a total of 415,744 gallons, or 138,805 gallons in excess of the amount of tax-paid gasoline purchased by Mr. Lockwood during the month of July from licensed distributors. These 138,805 gallons appear as item four on the notice of determination attached to appellant's proof of claim as Exhibit "B." (It should be noted at this point that the witness Lyles explained to the Honorable Referee that brokers under the California Motor Vehicle Fuel License Tax Law may only handle

tax-paid gasoline. It should also be noted [see Tr. 141] that the physical inventory taken on July 31, 1945 disclosed 49,354 gallons on hand—there is apparently a typographical error in the transcript at page 139.)

Having tied down his calculations and audit to the physical inventory taken of the gallonage held by Mr. Lockwood on July 31, 1945, and not having a physical inventory for the close of the month of August but having such an inventory for the close of September, Mr. Lyles then continued his audit and calculations by treating the months of August and September as a unit. Taking the physical inventory of July 31, 1945, as the opening inventory for the month of August [Tr. 141, *et seq.*], or 49,354 gallons, and adding thereto 2,789 gallons of pressure appliance fuel and purchases totaling 164,081 gallons, we find that a total of 216,224 gallons of tax-paid fuel were available for sale during the month of August. Not having a closing inventory for the month of August, and Mr. Lockwood's books and records disclosing sales of 185,221 gallons during the month of August, Mr. Lyles proceeded with his audit and calculations on the necessary assumption that the opening inventory for September of 1945 was the total amount available for sale during August, or 216,224 gallons less 185,221 gallons (the sales disclosed by Mr. Lockwood's books and records), or 31,003 gallons. Adding to the 31,003 gallon opening inventory for September purchases of tax-paid gasoline disclosed by Mr. Lockwood's books and records amounting to 46,530 gallons, Mr. Lyles ascertained that the total amount of tax-paid gasoline purchased by Mr. Lockwood from licensed distributors and available for sale during the month of September, 1945, amounted to 77,533 gallons. Although the sales disclosed by Mr. Lockwood's books

and records amounted to only 63,084 gallons, the physical closing inventory for the month of September, 1945, amounted to 32,236 gallons, making a total gallonage of gasoline sold and remaining on hand in the amount of 95,320 gallons. This latter amount exceeds the total tax-paid amount available for sale (77,533 gallons) by 17,787 gallons. The excess gallonage amounting to 17,787 gallons appears as the fifth item on the notice of determination attached to appellant's proof of claim as Exhibit "B." [Tr. 142.]

After testifying, as aforesaid, how the gallonage upon which the notice of determination attached to appellant's proof of claim as Exhibit "B" was ascertained, Mr. Lyles then testified, commencing at page 142 of the transcript, that additional audit of Mr. Lockwood's records disclosed an 800 gallon error in entry for the month of January, 1945, and a 1,660 gallon item which had not been picked up previously in computing the sales made by Mr. Lockwood for the month of May, 1945. The 800 and 1,660 gallon items appear as items one and two on the notice of determination attached to appellant's proof of claim as Exhibit "C."

The District Judge in his formal order did not reverse the Referee with respect to the 792 gallons included in the notice of determination attached to appellant's proof of claim as Exhibit "D."

Commencing at page 149 of the transcript, we have Mr. Lyles' testimony describing the books and records kept by Mr. Lockwood and available for audit. The Court's attention is directed to the fact that Mr. Lockwood did not keep a general ledger for the calendar year 1945; that Mr. Lockwood did not keep a purchase record;

that Mr. Lockwood did not keep an invoice register; and that Mr. Lockwood did not keep a record of cash receipts disclosing the sources from which received. It is apparent from Mr. Lyles' testimony [Tr. 151, *et seq.*], that Mr. Lyles was compelled to check the original purchase invoices and verify them by reference to the records of Mr. Lockwood's vendors and to Mr. Lockwood's check register to ascertain purchases actually made from licensed distributors. It is to be noted that Mr. Lyles checked the records of those licensed distributors who sold to Mr. Lockwood for the purpose of ascertaining whether there were any purchases made by Mr. Lockkood of tax-paid gasoline other than those disclosed by the records upon which Mr. Lyles' audit was based. It is to be noted that Mr. Lyles did not find any additional purchases by Mr. Lockwood of tax-paid gasoline. [Tr. 151.]

It is also significant to note [Tr. 152] that in cases where Mr. Lockwood did file broker's reports, as required by the California Motor Vehicle Fuel License Tax Law, his reported purchases of tax-paid motor vehicle fuel disclosed by those reports jibed in each instance with the records upon which Mr. Lyles' audit was predicated.

Not only did Mr. Lyles check to ascertain whether Mr. Lockwood had made purchases of tax-paid gasoline from licensed distributors in addition to those disclosed by his records but Mr. Lyles also checked the records of Mr. Lockwood's vendees to ascertain whether the sales disclosed by Mr. Lockwood's records had in fact been made. We direct the Court's attention to Mr. Lyles' testimony commencing at page 152 of the transcript disclosing that he cross-checked 80% of the 1,190,446 gallons sold by Mr. Lockwood during the months of May, June, July, August and September, 1945, as disclosed by Mr. Lock-

wood's records as set forth above, and found that, of the *entire* 80% checked, *all* of the gallonage had actually been sold to and received by Mr. Lockwood's vendees. We particularly direct the Court's attention to the fact that of the 80%, or 816,000 odd gallons of sales cross-checked to Mr. Lockwood's vendees by Mr. Lyles, *he did not find a single instance in which the gallonage disclosed by Mr. Lockwood's sales records had not actually been sold to the vendees indicated.* [Tr. 154.]

The thoroughness of Mr. Lyles' audit procedure is again demonstrated by his testimony commencing at page 155 of the transcript to the effect that he also cross-checked his figures with the brokerage reports prepared by Mr. Lockwood disclosing his purchases of tax-paid gasoline from licensed distributors. And the validity of Mr. Lyles' audit was again demonstrated on cross-examination when he testified, commencing at page 162, that in cross-checking only the 80% of total sales previously referred to he found 165,502 gallons actually sold to and received by Mr. Lockwood's vendees in the month of May, 1945, in contrast to the sales reported by Mr. Lockwood on his brokerage report for that month amounting to merely 136,343 gallons. Similarly, 260,505 gallons were actually cross-checked as having been sold to and received by Mr. Lockwood's vendees during the month of June, 1945, whereas an incomplete brokerage report found in Mr. Lockwood's office disclosed sales amounting to only 217,597 gallons.

Reference to the cross-examination of Mr. Lyles, commencing at page 169 of the transcript, and the redirect examination of Mr. Lyles commencing at page 191 of the transcript, discloses again that the gallonage upon which Mr. Lockwood's additional tax liability for the

calendar year 1945 was predicated as disclosed by Exhibits "B" and "C" attached to appellant's proof of claim, was arrived at only after detailed cross-checking and verification to the fullest extent possible.

The tax liability disclosed by the notice of determination attached to appellant's proof of claim as Exhibit "E" for the months of April and May, 1946, was clearly established by the undisputed testimony of Mark Lickter, an auditor in the brokers' department of the Division of Motor Vehicle Fuel License Tax of the California State Board of Equalization. After testifying, commencing at page 197 of the transcript, that he had made an audit of Mr. Lockwood's books for the period January 1, 1946, to August 31, 1946, Mr. Lickter testified that audit of Mr. Lockwood's books and records as verified by a cross-check with the records of his vendees for the month of April, 1946, disclosed sales and a closing inventory for that month exceeding the opening inventory for that month, and tax paid purchases made from licensed distributors during that month by 20,988 gallons. It was further Mr. Lickter's testimony [Tr. 198] that Mr. Lockwood had omitted from the total sales shown on his brokerage report for the month of April, 1946, sales disclosed by various invoices which constituted a part of his records. The 20,988 gallons sold, as aforesaid, and not shown to have been purchased tax-paid from a licensed distributor were set up as item one on the notice of determination attached to appellant's proof of claim as Exhibit "E."

The 2,920 item appearing on the notice of determination attached to appellant's proof of claim as Exhibit "E" as additional gallons distributed during the month of May, 1946, were found by Mr. Lickter, and he so testified, to

have resulted from an error in addition made by Mr. Lockwood in footing the totals on his sales record. It is significant to note that the cross-examination of Mr. Lickter, like the cross-examination of the witness Lyles, served again only to establish that these witnesses had carefully computed and cross-checked all the figures used by them in the course of their audit of Lockwood's activities during the periods involved. See, also, Mr. Lickter's redirect examination [Tr. 218-219] with reference to the assessments against Mr. Lockwood for the months of April and May, 1946.

The testimony of the witness Wakefield [Tr. 220-221] discloses that Mr. Lockwood was licensed as a *broker* of motor vehicle fuel in April of 1944, and that the witness had taken Mr. Lockwood's application for the broker's license and that the witness had given Lockwood a copy of the Board's General Order relating to the requirement that brokers keep adequate records of purchases and sales. (See, also, Section 8304 of the Motor Vehicle Fuel License Tax Law, California Revenue and Taxation Code.)

The testimony of Harold S. Williams, Supervising Investigator for the State Board of Equalization, commencing at page 222 of the transcript, discloses that this witness and the witness Wakefield took the physical inventory of motor vehicle fuel held by Mr. Lockwood on July 31, 1945, *supra*. It was Mr. Williams' testimony that Mr. Lockwood had no equipment of his own for the taking of a physical inventory and that Mr. Lockwood had stated he had never taken a physical inventory of his petroleum products.

Mr. Williams further testified, commencing at page 225 of the transcript, that there were four principal sources during the period herein involved, while gasoline ration-

ing was in effect, from which tax-free gasoline might be obtained from other than a licensed refinery. The first source was untaxed gasoline sold to the Federal Government and its agencies (see the exemption provisions contained in Section 7401 of the Motor Vehicle Fuel License Tax Law, California Revenue and Taxation Code), and stolen from the governmental agency. The second source involved direct thefts from licensed distributors through collusion by employees, tank truck drivers and others. The third source involved illegally branding petroleum products and special selling of those products such as paint thinner. The fourth source was the gasoline obtained by unlicensed distributors from theoretically empty barrels or other containers obtained by them from the armed forces. For example, Mr. Williams testified to one instance where a purchaser of motor vehicle fuel containers from the armed forces accumulated 10,000 gallons of motor vehicle fuel a month by draining these theoretically empty containers. Additionally, private contractors who drained war plane fuel tanks prior to crating the planes for shipment accumulated this drained gallonage, which was, of course, untaxed.

To use the words of the Referee, "There were 109 ways of beating the laws."

Mr. Williams' testimony that Mr. Lockwood stated in his presence, as well as in the presence of the witness Lyles, that he, Lockwood, had been the biggest black market operator in gasoline in Southern California during the last six months of World War II is uncontradicted, as is Mr. Williams' testimony regarding Mr. Lockwood's possession of a large quantity of ration books and stamps and coupons apparently purchased by him in connection with his black market operations. Mr. Williams' further testi-

mony that Mr. Lockwood again attributed the discrepancies in his records to his black market operations in the presence of two other employees of the Board of Equalization is also uncontradicted. Although the attorney for Mr. Lockwood sought on cross-examination of Mr. Williams to bring out the fact that Mr. Lockwood had stated he made out false sales tickets to acquire additional ration stamps, counsel for Mr. Lockwood ignored entirely the cross-checking done by the witnesses Lyles and Lickter to the records of Lockwood's vendees.

Commencing at page 232 of the transcript, Mr. Lockwood testified that he was not a licensed distributor under the California Motor Vehicle Fuel License Tax Law and that he had been served with notices of determination, copies of which are attached to appellant's proof of claim as Exhibits "B," "C," "D" and "E." As a matter of fact, to settle this point, reference to page 235 of the transcript reveals that it was stipulated Mr. Lockwood had received the aforesaid notices of determination and that his liability under the California Motor Vehicle Fuel License Tax Law, if any, was the liability disclosed by said notices of determination.

To settle, also, any question as to whether or not all of Mr. Lockwood's records were checked by appellant as well as by Mr. Lockwood and Mr. Lynch, the then Receiver under Chapter XI presently the Trustee in Bankruptcy, the Court's attention is directed to Mr. Lockwood's testimony, commencing at page 235 of the transcript, that he had turned over *all* of his books and records to Mr. Lynch.

After counsel for appellant rested [Tr. 236], Mr. Lockwood was called as a witness in his own behalf. The sole testimony given by Mr. Lockwood conflicting with the testimony of witnesses produced on behalf of appellant was

his monosyllabic denial [Tr. 236] that he had ever purchased any gasoline from other than a licensed distributor during the periods here in question and his monosyllabic affirmance [Tr. 238] that all the gasoline purchased by him during the periods in question were tax-paid. A review of Mr. Lockwood's testimony, commencing at page 236, fails to disclose any explanation of the discrepancies discovered and verified by the auditors and investigators for the California State Board of Equalization. Although the witnesses for appellant testified that they had not only cross-checked their figures with the records of vendees for Mr. Lockwood but also had cross-checked Mr. Lockwood's purchases with the records of his vendors, none of the testimony given by appellant's witnesses in that connection was refuted or explained by Mr. Lockwood. Although Mr. Lockwood sought to infer that some of the gallonage set up by the auditors from his records was attributable to his (Lockwood's) practice of issuing duplicate invoices, he failed to explain how the auditors employed by the California State Board of Equalization in cross-checking Lockwood's records to the records of his vendees were able to verify every item of the 80% checked. Additionally significant is the fact that the objecting parties [see Tr. 243, *et seq.*] were unable to produce from Lockwood's records any duplicate invoices which might have affected the assessments under consideration. Reference to the transcript at page 246 discloses that Mr. Lockwood was given a week to examine all his records which he had previously testified had been turned over to Mr. Lynch, the then Receiver in Chapter XI proceedings, for the purpose of directing the Court's attention to all material duplicate invoicing. Although reference to the transcript, commencing at page 247, discloses that Mr. Lock-

wood had in fact three weeks during which to produce any duplicate invoices which might possibly have affected the computations made by plaintiff's witnesses, it is to be noted [Tr. 281, *et seq.*] that none of the alleged "duplications" found by Mr. Lockwood had any effect whatsoever upon the computations made by the auditors who examined Mr. Lockwood's books and records and cross-checked those books and records with the records of Mr. Lockwood's vendors and Mr. Lockwood's vendees.

Reference to the testimony of Mr. Lockwood at page 258 of the transcript, as well as to the testimony of Lloyd Dyer (a former employee of Mr. Lockwood's), and the further examination of Virgil M. Lyles, commencing at page 281 of the transcript, makes it clear that in addition to the invoices employed by Mr. Lockwood in the course of his business operation there were also employed some receipt forms which did not enter into the computations made by the auditors employed by the State Board of Equalization; and it is clear that the manner in which Lockwood's vendees paid him as evidenced by receipts would not in any way affect the gallonage disclosed by invoices cross-checked to the vendee's record of purchases.

The testimony of H. Clay Reavis, commencing at page 278 of the transcript, establishes that the records of the Bell Oil & Refining Company to and including March 31, 1946, had been audited by the California State Board of Equalization and that no sales had been made by Bell after that date. The Court's attention is directed to this testimony in view of the stipulation requested by counsel for Mr. Lockwood at page 247 of the transcript and other references to Bell Oil Company appearing in the course of cross-examination of appellant's witnesses.

III.

Pertinent Provisions of the California Motor Vehicle Fuel License Tax Law.

SECTION 7351:

"Rate of tax. For the privilege of distributing motor vehicle fuel a license tax is hereby imposed upon distributors at the rate of three cents ($0.03) for each gallon of fuel distributed by them in this State until July 1, 1947. Thereafter the rate shall be four and one-half cents ($0.04½) for each gallon of fuel distributed."

SECTION 7303:

" 'Motor vehicle.' 'Motor vehicle' includes every self propelled vehicle operated or suitable for operation on the highway."

SECTION 7304:

" 'Motor vehicle fuel.' 'Motor vehicle fuel' includes gasoline, natural gasoline, and any inflammable liquid, by whatever name the liquid may be known or sold, which is used or is usable for propelling motor vehicles operated by the explosion type of engine. It does not include kerosene.

SECTION 7305:

" 'Distribution.' 'Distribution' includes any of the following:

(a) The refining, manufacturing, producing, blending, or compounding of motor vehicle fuel in this State, and the sale, donation, consignment for sale, barter, or use of the fuel in this State.

(b) The refining, manufacturing, producing, blending, or compounding of motor vehicle fuel in this State from petroleum products owned by another and

the delivery of the fuel in this State to the owner thereof or to any person on his order.

(c) The importing of motor vehicle fuel into this State, and the sale, donation, consignment for sale, barter, or use of the fuel in this State unless the State is prohibited by the Constitution or laws of the United States from imposing a tax with respect to such sale, donation, consignment for sale, barter or use.

(d) The receiving in this State of motor vehicle fuel with respect to which there has been no prior taxable distribution and the sale, donation, consignment for sale, barter, or use of the fuel in this State.

(e) The withdrawal of motor vehicle fuel from storage in this State for the purpose of the sale, donation, consignment for sale, barter or use of the fuel in this State if the consummation of such purpose does not otherwise constitute a distribution taxable under this part, in which event the license tax with respect to the fuel withdrawn from storage is measured by the gallonage thereof thus sold, donated, consigned for sale, bartered or used.

SECTION 7306:

"'Distributor.' 'Distributor' includes every person who, within the meaning of the term 'distribution' as defined in this chapter, distributes motor vehicle fuel and also includes every person who refines, manufactures, produces, blends or compounds motor vehicle fuel in this State and every person who imports motor vehicle fuel into this State or who receives in this State motor vehicle fuel of which there has been no prior taxable distribution."

SECTION 7307:

"'Producer.' 'Producer' includes every person, other than a distributor, engaged in the business

of producing or manufacturing kerosene distillate, kerosene, Diesel fuel, gas oil, stove oil, distillate or any other petroleum product used in, or which may be used in, the blending, compounding, or manufacturing of motor vehicle fuel. 'Producer' does not include a person whose business with respect to petroleum products is confined to the production, purchase or sale of crude oil which it is necessary to refine before it may be used in such blending, compounding, or manufacturing."

SECTION 7308:

"'Broker.' 'Broker' includes every person, other than a distributor, dealing, either as the owner or as the agent of another, in motor vehicle fuel, kerosene distillate, kerosene, Diesel fuel, gas oil, stove oil, distillate or any other petroleum product used in, or which may be used, in the blending, compounding, or manufacturing of motor vehicle fuel. 'Broker' does not include anyone dealing in such fuel or product only in quantities of less than 200 gallons nor a person whose business with respect to petroleum products is confined to the dealing in crude oil which it is necessary to refine before it may be used in such blending, compounding, or manufacturing, nor a nonprofit agricultural cooperative association, organized and acting within the scope of its powers under Chapter 4 of Division 6 of the Agricultural Code, dealing only with its members and storing, selling, furnishing or delivering petroleum products, other than the fuels with respect to which a tax is imposed under this part or Part 3 of this division, used exclusively for purposes of orchard heating to protect the crops of its members, and annually filing with the board an affidavit showing these facts."

Section 7352:

"Presumption of distribution. For the purpose of the proper administration of this part and to prevent evasion of the license tax, unless the contrary is established, it shall be presumed that all motor vehicle fuel refined, manufactured, produced, blended, or compounded in this State or imported into this State and no longer in the possession of the distributor has been distributed. This presumption can not be overcome by proof that the motor vehicle fuel has been converted to his own use by any person to whom the distributor has entrusted the control or possession of the fuel either as bailee, consignee, employee, or agent."

Section 7353:

"Fuel deemed distributed upon revocation or cancellation of license. Upon revocation or cancellation of the license of the distributor or his cessation of business, all motor vehicle fuel remaining in his possession or ownership shall be deemed distributed and subject to jeopardy determination as provided in Section 7698 if, in the judgment of the board, this is necessary to insure payment of the tax with respect to distribution of such fuel."

Section 7401:

"Exemptions: sales to United States armed forces, distributors; exports. The provisions of this part requiring the payment of license taxes do not apply to any of the following:

(a) Natural gasoline and liquefied petroleum gas distributed to a duly licensed distributor under such regulations as the board may prescribe.

(b) Motor vehicle fuel exported from this State by the distributor or delivered by the distributor to

any vessel clearing from a port of this State for a port outside of this State and actually exported from this State in the vessel.

(c) Motor vehicle fuel distributed, or delivered on the order of the owner, to a distributor who has furnished bond of one hundred thousand dollars ($100,000) as prescribed by Section 7454 and who has established to the satisfaction of the board that this bond, together with property to which the lien imposed by Section 7871 attaches, is sufficient security to assure payment of all license taxes as they may become due to the State from him under this part.

(d) Motor vehicle fuel sold to the United States armed forces for use in ships or aircraft, or for use outside this State.

Every distributor claiming an exemption shall report the exports, sales or distributions to the board in such detail as the board may require; otherwise the exemption granted in this section shall be null and void and all the fuel shall be considered distributed in this State subject fully to the provisions of this part."

SECTION 7354:

"Tax on one distribution only. The license tax shall be imposed upon only one distribution of the same motor vehicle fuel."

SECTION 7451:

"License. Every person before becoming a distributor shall apply to the board for a license authorizing the person to engage in business as a distributor. It is unlawful for any person to be a distributor without first securing a license."

Section 7493:

"Notice of hearing. The notice may be served personally or by mail. If by mail, service shall be made pursuant to Section 1013 of the Code of Civil Procedure and shall be addressed to the applicant at his address as it appears in the records of the board, but the service shall be deemed complete at the time of the deposit of the notice in the mail without extension of time on account of the distance between the place of deposit and the place of address."

Section 7651:

"Distributor's report required. Each distributor shall prepare and file with the board on forms prescribed by the board a return verified by oath showing the total number of gallons of motor vehicle fuel distributed by him within this State during each calendar month, or such monthly period ended during that calendar month as the board may authorize, the amount of license tax due for the month covered by the return, and such other information as the board deems necessary for the proper administration of this part. The distributor shall file the return on or before the first day of the secontd calendar month following the monthly period to which it relates, together with a remittance payable to the Controller for the amount of license tax due for that period less whatever amounts may have been paid theretofore for the same period because of returns and payments made on a weekly basis."

SECTION 7700:

"Petition for redetermination; security. The distributor against whom a jeopardy determination is made may petition for the redetermination thereof pursuant to Article 3.5 of this chapter. He shall, however, file the petition for redetermination with the board within 10 days after the service upon him of notice of the determination. At the time of filing the petition for redetermination, the distributor shall deposit with the board such security as it may deem necessary to insure compliance with this part."

SECTION 7706:

"Interest. All jeopardy determinations including those made under Section 7704, exclusive of penalty, shall bear interest at the rate of one-half of 1 percent per month, or fraction thereof, from the first day of the second calendar month following the close of the monthly period for which the amount or any portion thereof should have been returned until the date of payment."

SECTION 7726:

"Payments by unlicensed distributors. If any person becomes a distributor without first securing a license, the license tax becomes immediately due and payable on account of all motor vehicle fuel distributions made by him.

If a broker makes sales or otherwise disposes of motor vehicle fuel the aggregate gallonage of which is in excess of his acquisitions of that fuel from distributions with respect to which the tax has been

paid, as disclosed by his inventories and records of purchases, he shall be regarded as an unlicensed distributor of that excess of motor vehicle fuel and shall be subject to the provisions of this article as an unlicensed distributor of that fuel, unless he shall establish that the license tax has been paid with respect to all fuel sold or otherwise disposed of by him."

SECTION 7727:

"Unlicensed distributor determination; penalty. The board shall forthwith ascertain as best it may the amount of the distributions and shall determine immediately the license tax on the amount, adding to the license tax a penalty of 100 percent of the amount of the tax, and shall give the unlicensed distributor notice of this determination as prescribed by Section 7493. Provisions of Sections 7699 and 7700 shall be applicable with respect to the finality of the determination and the right of the unlicensed distributor to petition for a redetermination."

SECTION 7728:

"Jeopardy determination collection. The board shall file a copy of this jeopardy determination with the Controller who shall forthwith collect the license tax, penalty and interest due from the unlicensed distributor by seizure and sale of property in the manner prescribed for the collection of a delinquent monthly license tax."

SECTION 7729:

"Court action. At the request of the Controller the Attorney General shall commence and prosecute to

final determination an action at law to collect the license tax, penalty and interest, or any part thereof, determined against an unlicensed distributor."

SECTION 7730:

"*Prima facie* evidence. In the suit a copy of the jeopardy determination certified by the secretary of the board or by the Controller, shall be *prima facie* evidence that the unlicensed distributor is indebted to the State in the amount of the license tax, penalties and interest computed as prescribed by Section 7706."

SECTION 7871:

"Lien, priority of. The license tax, together with all penalties, interest and costs accruing thereupon or with respect thereto, is a lien upon all property of the distributor, attaching at the time of the distribution subject to the license tax. The lien is paramount to all private liens or encumbrances of whatever character and has the effect of an execution duly levied against all property of the distributor. The lien remains until the license tax, together with all penalties, interests and costs accruing thereupon or with respect thereto, is paid or the property sold in payment thereof."

SECTION 7981:

"*Prima facie* evidence. In any suit brought to enforce the rights of the State under this part a copy of the return filed with the board by the distributor, certified by the secretary of the board, or a copy of the notice of determination prepared by the board and filed with the Controller, certified either by the sec-

retary of the board or the Controller, showing unpaid license taxes, penalties, or interest assessed or determined against any distributor, shall be *prima facie* evidence of the following:

(a) The determination of the license tax, the delinquency thereof, and the amount of the license tax, penalties, and interest due and unpaid to the State.

(b) The indebtedness of the distributor to the State in the amount of the license tax, penalties and interest therein appearing unpaid.

(c) The full compliance by all persons required to perform administrative duties under this part with all the forms of law in relation to the determination and levy of the license tax, penalties and interest."

SECTION 8251:

"Administration procedure. The board shall enforce the provisions of this part, except insofar as duties and powers are vested in the Controller, and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this part. The board may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect."

SECTION 8252:

"Administrative representatives. The board may employ attorneys, accountants, auditors, investigators, and other expert and clerical assistance necessary to enforce its powers and perform its duties under this part."

SECTION 8253:

"Examination of licensee records. The board may make such examinations of the records of distributors, producers and brokers and such other investigations as it may deem necessary in carrying out the provisions of this part."

SECTION 8301:

"Records of distributors, form, etc. Every distributor shall keep an accurate record in such form as the board may prescribe of all of the following:

(a) All stocks of petroleum products on hand.

(b) All raw gasoline, gasoline stock, kerosene distillates, casing-head gasoline, and other petroleum products used in, or which may be used in, compounding, blending, or manufacturing motor vehicle fuel.

(c) The amount of crude oil refined, the gravity of the crude oil refined, and the yield from the crude oil.

(d) Such other matters relating to transactions in petroleum products as the board may require."

SECTION 8302:

"Inventory by distributor. Every distributor shall take a physical inventory of the petroleum products on hand at least once each month as prescribed by the board and keep a record of the inventory. If the board or its representatives are dissatisfied with the accuracy of the inventory, they may take a physical inventory of the petroleum products."

SECTION 8303:

"Producer's records. Every producer shall keep an accurate record in such form as the board may prescribe of all manufacture, sales, and deliveries of kerosene distillate, kerosene, Diesel fuel, gas oil, stove oil, distillate and any other petroleum product used in, or which may be used in, the blending, compounding, or manufacturing of motor vehicle fuel."

SECTION 8304:

"Broker's records. Every broker shall likewise keep an accurate record of all purchases and sales of motor vehicle fuel and petroleum products mentioned in Section 8303, the record to show the vendor and vendee, the quantity purchased and sold, the correct description of the commodity, and the means of transportation from the vendor to the broker and from the broker to his vendee."

SECTION 8305:

"Inspection of records. All records required by this chapter shall be available at all times for the inspection of the board or its representatives."

SECTION 8307:

"Producer and brokers' monthly reports. On or before the fifteenth day of each month, every producer and broker shall file on forms prescribed by the board a report showing such information with respect to the operations of the preceding calendar month as the board may require to carry out the provisions hereof."

ARGUMENT.

I.

The Findings Made by the Referee Are Amply Supported by the Record and Should Not Be Disturbed.

Appellant is frankly unable to comprehend how the District Judge could have concluded that the findings made by the Referee are not supported by the record. Considering the Referee's finding [Tr. 56, *et seq.*] in light of the record, we note that Mr. Lockwood's petition under Chapter XI was filed on August 30, 1946 [Tr. 10], as set forth in the Referee's Finding I; that the Controller filed a verified proof of claim on Oct. 4, 1946 [Tr. 20-22] as set forth in the Referee's Finding II; that written objections to the aforesaid claim were filed by Mr. Lockwood and Mr. Lynch on October 11, 1946 [Tr. 24-25] as set forth in the Referee's Finding III; that appellant's amended proof of claim was filed on October 17, 1946 [Tr. 26-32] as set forth in the Referee's Finding IV; that Mr. Lockwood and Mr. Lynch filed objections to said amended proof of claim on October 22, 1946 [Tr. 33-35] as set forth in the Referee's Finding V; that Mr. Lockwood was doing business as the Dependable Oil Company during the months of January, May, June, July and September, 1945, and the months of April and May, 1946 [see Lockwood's petition under Chapter XI, Tr. 3-10], as set forth in the Referee's Finding VI; that during the aforesaid months Lockwood was engaged in the business of making sales of motor vehicle fuel (see foregoing analysis of reporter's transcript) as set forth in the Referee's Finding VII; that during the aforesaid months Mr. Lockwood had neither applied for nor secured a distributor's license under the provisions of the California

Motor Vehicle Fuel License Tax Law (see foregoing analysis of reporter's transcript) as set forth in the Referee's Finding VIII; that during the aforesaid months Mr. Lockwood distributed the gallonage disclosed by auditors for the California State Board of Equalization as not having been obtained tax-paid from distributors licensed under the provisions of the California Motor Vehicle Fuel License Tax Law as set forth in the Referee's Finding IX; that the tax imposed by the California Motor Vehicle Fuel License Tax Law upon the distribution of the aforesaid gallonage had at no time been paid, as established by the uncontradicted testimony of the auditors and investigators for the California State Board of Equalization who had made a thorough and extensive check to ascertain the sources from which Mr. Lockwood derived the motor vehicle fuel sold by him, as set forth in the Referee's Finding X; that the amended proof of claim filed by appellant on or about October 17, 1946, is predicated solely upon the distribution of the aforesaid gallonage, as is apparent from the foregoing analysis of the reporter's transcript and as is set forth in the Referee's Finding XI; that none of the amounts claimed in the aforesaid amended proof of claim filed by the Controller on October 17, 1946, have been paid (see the foregoing analysis of reporter's transcript) as set forth in the Referee's Finding XII.

As we have pointed out above in our analysis of the reporter's transcript, it is clear from the testimony of all the witnesses excepting Mr. Lockwood that Mr. Lockwood sold motor vehicle fuel in gallonage exceeding the amount he purchased tax-paid from licensed distributors. It is additionally clear that Mr. Lockwood had been engaged in black market operations during the taxable pe-

riods in question and that Mr. Lockwood himself was unable to account for the sources of the fuel actually sold by him as established by audit of his vendees' records. The only testimony offered in support of the objections filed by Mr. Lockwood and the Receiver in the then pending Chapter XI proceedings was Mr. Lockwood's monosyllabic denial [Tr. 236] that he had ever purchased gasoline from a company other than a licensed distributor and his monosyllabic affirmance [Tr. 238] that all the gasoline he had purchased for distribution during the calendar years 1945 and 1946 had been purchased tax-paid. *It is to be noted that Mr. Lockwood did not deny that he had been engaged in black market activities.*

It is apparent, accordingly, that the conflicting evidence before the Referee consisted on the one hand solely of Mr. Lockwood's two-worded testimony that he had purchased only tax-paid gasoline from licensed distributors and, on the other hand, of the balance of the entire record. The Referee had Mr. Lockwood before him and had the opportunity to evaluate Mr. Lockwood's credibility as well as the credibility of all the other witnesses.

As we have stated above, we are frankly unable to comprehend how the District Judge could have held that the Referee's Findings are not supported by the record. General Order 47 requires a District Judge to accept a Referee's Findings of Fact unless they are clearly erroneous, and a similar provision is contained in Rule 53(e)(2) of the Federal Rules of Civil Procedure. Additionally, the courts have long held that the deliberate judgment of a Referee who saw the witnesses and heard their stories at length must be accepted unless clearly erroneous, inasmuch as the Referee is in a much better position than either the District Court or the Circuit Court

to pass on the credibility of witnesses. As Judge Healy of this Court stated in *Powell et ux. v. Wumkes,* 142 F. 2d 4, 6:

> "Order 47 is not too happily phrased, but considering its provisions in their entirety it would seem that they do not shackle the judge to the extent that an appellate court is circumscribed by Rule 52(a) of the Rules of Civil Procedure, 28 U. S. C. A., following section 723c. The judge has large supervisory powers. Where he confines himself to a review of the record made before the referee *he is not permitted to try factual questions de novo,* that is to say, *he is not at liberty to reject the findings of the referee merely because he disagrees with the latter as to the credibility of witnesses or the weight to be accorded conflicting evidence.* But unlike an appellate court the judge is empowered, in appropriate circumstances, to receive further evidence; and on the basis of the enlarged record he may modify or make findings, or may recommit the matter for further hearing by the referee." (Emphasis added.)

Judge Wilbur, formerly of this circuit, in *Weisstein Bros. & Survol v. Laugharn,* 84 F. 2d 419, 420, recognized the existence of,

> ". . . the familiar rule that where facts are litigated before the referee, and where the witnesses appeared before him, and a decision upon the controverted facts had been made by him, the court will not ordinarily be justified in reversing the finding of the referee as to the controverted facts. In re Gordon & Gelberg (C. C. A.), 69 F. (2d) 81, 83; Rasmussen v. Gresly (C. C. A.), 77 F. (2d) 252; Remington on Bankruptcy (4th Ed.), vol. 8, 3669, p. 41; Ingram v. Lehr (C. C. A.), 41 F. (2d) 169, 170."

The Honorable Leon R. Yankwich, District Judge, quoted the foregoing portion of Judge Wilbur's decision in the *Weisstein Bros.* case, *supra,* in *In re Alberti,* 41 Fed. Supp. 380, 381, and concluded that:

> "This means that, while, *on conflicting testimony, we must follow the findings of the referee* (or the commissioner), when there is no conflict of testimony, or when the testimony upon which the decision is based is not legally entitled to the effect which the commissioner has given to it, there is no evidence whatsoever to sustain the commissioner." (Emphasis added.)

The decision of this Court in *Ott v. Thurston et al.,* 76 F. 2d 368, 369, is also pertinent:

> "Another error stressed by appellant is that the judge of the District Court erred in holding that where the evidence introduced before the referee in bankruptcy was conflicting, he was not at liberty to disregard the referee's findings. In that connection, the District Court stated in its opinion: 'The evidence was at least conflicting, the District Court is not at liberty to disregard the Referee's finding for they find sufficient support in the evidence.' *The court was here expressing the general rule of practice on review or appeal.*
>
> "It is the recognized rule of the federal courts—and especially in matters of bankruptcy—that on review of the decision of a referee, based upon his conclusions on questions of fact, the court will not reverse his findings unless the same are so manifestly erroneous as to invoke the sense of justice of the court.' *In re* Stout, 109 F. 794 (D. C. Mo.), See, also, *In re* Noyes Bros., 127 F. 286 (C. C. A. 1)." (Emphasis added.)

In *McDonald v. First Nat. Bank of Attleboro,* 70 F. 2d 69, 71, Judge Morton of the First Circuit, in reversing a district judge who had reversed a referee, stated:

> "A referee's findings 'have every reasonable presumption in their favor, and should not be set aside or modified, unless it clearly appears that there was error or mistake on his part.' [Citing cases.] Upon a careful examination of the record, we are unable to agree with the District Judge. The critical findings of the referee do not appear to us to be clearly wrong. Without undertaking to analyze the evidence and findings in detail, we think the referee's conclusion . . . was by no means unreasonable. . . ."

In *Morris Plan Industrial Bank v. Henderson,* 131 F. 2d 975, the Court of Appeals for the Second Circuit had occasion to consider an appeal from an order of the District Court reversing the order of a referee granting a bankrupt's discharge. The first question considered by the Circuit Court was the extent to which they should review the proceedings below, and Judge Learned Hand in writing the decision disposed of this point as follows:

> "The first question is as to the extent of our review: whether the case comes before us as it came before the district judge, or whether he had a larger latitude in reviewing the referee's findings than we have. General Order 47, 11 U. S. C. A. following section 53, requires the judge to 'accept his [the referee's] findings of fact unless clearly erroneous.' These are the same words as those used in Rule 53 (e) (2), 28 U. S. C. A. following section 723c, and substantially the same as those in Rule 52(a) which requires us not 'to set aside' the finding of a

judge unless it too is 'clearly erroneous.' It is true that logically a distinction can be drawn between holding a referee's finding to be 'clearly erroneous' and holding a judge's finding that a referee's finding is 'clearly erroneous' to be 'clearly erroneous.' Possibly the Seventh Circuit meant to make that distinction in a case that arose under General Order 47 before it was amended. *In re* Duvall. 103 F. 2d 653. We should regret. however. to be compelled now to introduce such refinements into the solution of what is after all only a practical problem. Everyone forms his conclusions from testimony. not only from the words which he hears the witnesses utter but from their appearance when they utter them: and the added weight to be attached to a referee's finding. or to a judge's (if he sees the witnesses) depends upon the fact that he has in effect had evidence before him which cold print does not preserve. So far, therefore, as the words themselves leave any latitude, the referee's conclusion ought to prevail because we cannot appraise the cogency of the lost evidence. In the end, as we have often said. the responsibility for the right conclusion remains the judge's as indeed it does ours; *In re* Kearney, 2 Cir., 116 F. 2d 899; but we have again and again held that except in plain cases he should accept the referee's findings. [Citing cases.] We therefore hold that the question is the same in this court as it was in the district court."

See, also:

Kowalsky v. American Employers Ins. Co., 90 F. 2d 476;

In re Gallis, 115 F. 2d 626, cert. den. 312 U. S. 704, 85 L. Ed. 1137, 61 S. Ct. 808.

II.

The Record Herein Clearly Establshes the Tax Liability Upon Which Appellant's Proof of Claim Is Predicated.

Although it is, of course, the well established rule that verified proofs of claim are *prima facie* correct and that an objecting party has the burden of going forward with sufficient evidence or testimony to overcome the *prima facie* correctness of a properly verified claim, and although appellant submits that there is nothing in the record herein sufficient to support the objections filed by Mr. Lockwood and Mr. Lynch, the then Receiver in Chapter XI proceedings, nor sufficient to have justified a ruling that the *prima facie* validity of appellant's claim had been overcome and that appellant had the burden of going forward and proving his claim (as the Referee below held), we nevertheless desire to direct the Court's attention to the fact that the record herein fully establishes the tax liability upon which appellant's proof of claim is predicated.

Both the California and the Federal Courts, including the United States Supreme Court, have held in tax refund suits that *even where a tax assessment is predicated upon an audit made without regard for a taxpayer's books and records*, the taxpayer nevertheless has the burden of showing that the amount of the assessment is not due and owing under the taxing statute.

United States v. Jefferson Electric Co., 291 U. S. 386, 402, 54 S. Ct. 443, 449, 78 L. Ed. 859;

Lewis v. Reynolds, 284 U. S. 281, 283, 52 S. Ct. 145, 146, 76 L. Ed. 293;

Claflin v. Godfrey, 21 Pick. 1, 6;

Van Antwerp v. United States (C. C. A. 9), 92 F. 2d 871, 873-874;

People v. Schwartz, 31 Cal. 2d 59;

People v. Mahoney, 13 Cal. 2d 729;

Maganini v. Quinn, 99 A. C. A. 1, 5, *et seq.* (Hearing denied by the California Supreme Court October 2, 1950);

Pacific Fruit Express Co. v. McColgan, 67 Cal. App. 2d 93, 96.

The decision of the Court of Appeals for the Sixth Circuit in *Rogers v. Commissioner of Internal Revenue,* 111 F. 2d 987, 988-989, in considering an appeal from a decision of the former Board of Tax Appeals (presently the United States Tax Court) affirmed a decision of the Board of Tax Appeals in upholding deficiency assessments levied by the Commissioner of Internal Revenue sets forth the rule requiring the taxpayer to come forward with a reasonable explanation:

> "We think the Board did not err. . . . The finding of the Commissioner is *prima facie* correct, and petitioners have the burden of proving what part of the amount determined to be a deficiency is not due. Welch v. Helvering, 290 U. S. 111, 54 S. Ct. 8, 78 L. Ed. 212; United States v. Peabody Co., 6 Cir., 104 F. 2d 267; Commissioner v. Volunteer State Life Ins. Co., 6 Cir., 110 F. 2d 879, decided March 12, 1940. Petitioners have not sustained this burden. The records of the company were loosely kept, in that Rogers instructed the bookkeeper what entries to make. Petitioners kept no personal records. Evidence as to their income consists of sketch memoranda, and information emanating from the uncertain memory of

> Charles A. Rogers. Rogers' testimony on the point is confused and evasive. He made references to memoranda which were not produced, and stated that he did not know where they were. It was Rogers who directed that [a certain . . .] journal entry . . . be made. Rogers at the time of the hearing was serving sentence for conviction of embezzlement of city funds. . . . The Board's finding is a determination of a question of fact, and if supported by the record, should be affirmed unless clearly erroneous. [Citing cases.]"

See, also:

McClure v. United States, 48 Fed. Supp. 531;

Guaranty Trust Co. v. United States, 44 Fed. Supp. 417.

As the Federal Courts have often stated, the rationale behind placing the burden upon the taxpayer to come forward to show a tax assessment is not due and owing is that the taxpayer, being the most intimately acquainted with the facts, should be able to produce them. In the instant case, the parties objecting to appellant's claim, in the proceedings had before the Referee, failed to come forward with any explanation sufficient to even infer a legitimate tax-paid source for the gallonage which the uncontroverted testimony establishes was sold by Mr. Lockwood. We are unable to comprehend how the District Judge could have ignored the fact, as established by the record, that Mr. Lockwood's purchases and sales

were cross-checked to the records of his vendors and vendees and that Mr. Lockwood failed to come forth with even one additional possible source of tax-paid motor vehicle fuel. (See Section 7726 of the California Motor Vehicle Fuel License Tax Law, *supra.*)

We will not burden the Court with a detailed review of the facts in light of the pertinent provisions of the California Motor Vehicle Fuel License Tax Law set forth above. Briefly summed up, however, it is clear that Mr. Lockwood distributed, within the meaning of Section 7305 of the Motor Vehicle Fuel License Tax Law the gallonage of motor vehicle fuel (as defined by Section 7304 of the Motor Vehicle Fuel License Tax Law) in the gallonages set forth in the notices of determination duly issued by the Board of Equalization and mailed to Mr. Lockwood as the taxing statute requires. Reference to the statutory provisions will disclose that the tax, penalties and interest were computed upon the aforesaid gallonages as provided by the statute and as set forth in the copies of the notices of determination attached to appellant's proof of claim as Exhibits "B," "C," "D" and "E." Reference to Section 7871 of the Motor Vehicle Fuel License Tax Law, as it read during the taxable periods involved, will disclose that a lien upon all of Mr. Lockwood's property in the amount of tax, penalties and interest attributable to his monthly distribution of the gallonages involved attached to all his property at the time of said distributions.

III.

Mr. Lockwood Having Filed the Only Petition for Review of the Referee's Order Allowing Appellant's Claim in Full, and Lockwood Having Abandoned Said Petition, the District Court Erred in Permitting Others to Review the Referee's Order and Others Should Not Be Permitted to Prosecute This Appeal.

As we have pointed out in our Preliminary Jurisdictional Statement and as is disclosed by the full record herein, although Mr. Lockwood and E. A. Lynch, as Receiver under Chapter XI, had filed objections to appellant's claim, Mr. Lynch was instructed not to petition for review of the Referee's Order and the only petition for review filed was the one filed by Mr. Lockwood. Mr. Lynch did not seek a review of the Referee's Order instructing him not to file a petition for review of the Order allowing appellant's claim. The record is additionally clear, as we have attempted to point out above, that after Mr. Lockwood filed his petition for review neither he nor his attorneys participated therein thereafter. To the contrary, Mr. Lockwood failed to take any steps to have a reporter's transcript prepared, and when, after more than six months had elapsed, counsel for appellant secured an order to show cause directed to Mr. Lockwood ordering him to appear and show cause why the Referee should not prepare his certificate on review without a reporter's transcript or a narrative statement of the evidence, neither Mr. Lockwood nor his attorney appeared on the return date. As is apparent from the affidavit of Harry A. Pines, Esq. [Tr. 65-71], one of the attorneys for E. A. Lynch, presently Trustee in Bankruptcy, and the Notice of Motion appearing at page

62 of the transcript herein, the attorneys for the trustee, in effect, took over Mr. Lockwood's petition for review through an Order of District Judge Harrison granting the attorneys permission to participate in Mr. Lockwood's petition for review as *amicus curiae*. It is also clear from the record that on February 28, 1949, Mr. Pines, as attorney for Mr. Lynch, Trustee in Bankruptcy herein, made a motion before District Judge Beaumont for an Order permitting the trustee to add a reporter's transcript to the record on Mr. Lockwood's petition for review, and it is to be noted that Mr. Pines, as attorney for Mr. Lynch, argued the motion, representing to the Court that the reporter's transcript would be furnished at the expense of the Ben Hur Refining Company, a creditor of the bankrupt estate. It is obvious that the Ben Hur Refining Company was willing to finance the preparation of the transcript inasmuch as the disallowance of appellant's lien claim would leave assets otherwise going toward satisfaction of appellant's claim available for payment of the Ben Hur Refining Company claim. The trustee's motion was duly granted by Judge Beaumont and the transcript was ordered prepared specifically at the expense of said Ben Hur Refining Company.

It is elementary that a District Judge can entertain a petition for review of a Referee's Order only if it is filed by someone having standing to review. (Remington on Bankruptcy (5th Ed.), Vol. 8, p. 7.)

Although it is true that all parties aggrieved by an Order entered by a Referee in Bankruptcy have standing to petition for review, it is equally well established that such aggrieved parties must either file their own petitions for review if they have been represented in the

particular proceeding or controversy in which the Order sought to be reviewed was entered; or, if they have not been represented in that particular proceeding or controversy, they must apply for leave to intervene for the purpose of filing their petitions for review. (Remington on Bankruptcy (5th Ed.), Vol. 8, p. 7, *supra.*)

It is clear from the record herein that E. A. Lynch, either as former Receiver under Chapter XI or as present Trustee in Bankruptcy of the estate of Mr. Lockwood, did not file a petition for review, and it would appear to necessarily follow from the foregoing that the trustee in bankruptcy herein had no standing before the District Judge, nor does he have any standing here. Even if it be argued that the Ben Hur Refining Company and the Trustee herein still had some standing after Mr. Lockwood abandoned his petition for review because they had relied on Mr. Lockwood's petition and had expected to benefit from his review, that argument is untenable because it is well established that not only may standing to petition for review be lost by failure to so do but also that a party expecting to benefit from a review taken by another cannot be substituted for the petitioner and permitted to prosecute his review when the latter has abandoned or wishes to abandon it. (Remington on Bankruptcy (5th Ed.), Vol. 8, pp. 7-8.)

In re Bender Body Co., 139 F. 2d 128;

In re Pramer, 131 F. 2d 733, 735.

Conclusion.

It is respectfully submitted that the Honorable Harry C. Westover, District Judge, erred in holding that the record herein does not support the findings made by the Referee, and, furthermore, that the Findings of Fact, Conclusions of Law and Order made by the Honorable Harry C. Westover are in and of themselves entirely unsupported by the record herein. It is further submitted that the Order of the District Judge disregarded entirely the well established principles relating to the manner in which disputed tax liabilities are finally determined.

Although not material to a determination of the propriety of the Referee's Order allowing appellant's claim in full, it is submitted that the Orders of the District Court permitting others than the petitioner for review to prosecute a petition after abandonment by the petitioner were improper, finding no sanction in statute, rule or decision and will set a dangerous precedent if not reversed by this Court.

The Order of District Judge Westover should be reversed, the Order of the Referee allowing appellant's claim in full should be reinstated.

Respectfully submitted,

EDMUND G. BROWN,
Attorney General;

JAMES E. SABINE,
Deputy Attorney General;

EDWARD SUMNER,
Deputy Attorney General,
Attorneys for Appellant.